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Winston Hickox, Chairman
Chair, California Market Advisory Committee
California Environmental Protection Agency
1001 I Street
Sacramento, CA 95814

Re: Comments of FPL Energy Project Management, Inc.
On Recommendations for Designing a Greenhouse Gas Cap and Trade System for California.

Dear Mr. Hickox and members of the Market Advisory Committee:

FPL Energy Project Management Inc.[1] (FPLE) respectfully submits its comments to the Market Advisory Committee (MAC) on the June 1, 2007 *Draft Recommendations for Designing a Greenhouse Gas Cap and Trade System for California (Draft Report).* FPLE appreciates the time and effort invested in the research, analyses, and discussion that led to the Draft Report. FPLE commends the MAC for their thoughtful consideration of the issues surrounding a market based greenhouse gas (GHG) emissions reduction program in California.

FPL Energy, LLC is a leading national independent energy provider with natural gas, wind, solar, hydroelectric, and nuclear power plants operating in 24 states. More than 90 percent of FPL Energy's electricity is generated by clean fuels. For the last several years, FPL Energy has been the leading producer of wind power in the United States and we operate the two largest solar fields in the world located in California's Mojave Desert. In California, we own 1,284 megawatts of generation, including 586 megawatts of wind generation, 147 megawatts of solar generation capacity, 507 megawatts of combined cycle gas-fired generation and 44 megawatts of coal-fired co-generation.

We found the report to be a very thorough discussion of the potential issues that will face the state in the future as programs to reduce GHG emissions are developed. As

[1] FPL Energy Project Management, Inc. is a subsidiary of FPL Energy, LLC that is in turn an affiliate of Florida Power and Light as part of FPL Group.

a component of our commitment to climate change, FPL Group, our parent company, has evaluated the potential impacts of future national GHG regulations and developed a climate change position as expressed in our Issue Brief titled *U.S. Climate Policy: Pricing Carbon* (attached).

FPL Group's analysis, prepared in conjunction with The Brattle Group of Cambridge, Massachusetts, concludes that goals for GHG emissions reductions would best be met through the application of a carbon price signal that would change the behavior of consumers and emitters. In FPL Group's Issue Brief, we suggest that the most efficient method of implementing this price signal would be through the use of a carbon fee that is applied upstream where GHGs first enter the economy.

Through our research, we have determined that the two critical goals for any climate change program are (1) preserving the environment and (2) protecting the economy. The following are elements of a successful market-based compliance program;

1. Mandatory;

2. Market-based;

3. Economy wide, and applied upstream;

4. Phased in gradually, with a predictable, long-term CO2 price trajectory;

5. Free of large transitional protections; and

6. Revenue neutral where all revenues collected are returned to the economy to advance carbon reduction including:

    a. Assistance to defraying the cost impact on low-income consumers.
    b. Investment in renewable and low emitting technologies.
    c. Research and development funds for carbon abatement and control technologies.

Although the Draft Report did not recommend a fee-based program, some of the MAC's recommended design features for a cap and trade system accomplish many of the same goals. Below we address our specific comments on the Draft Report. We have underscored only those areas where questions have arisen in our initial review.

FPLE supports a Safety Valve (Ceiling Price) and Floor Price for allowances

FPLE agrees with the Draft Report recommendation that a market based cap and trade program can result in a successful emissions reduction strategy. In addition to the basic program elements of a cap and trade program, California should implement a safety valve price that minimizes potentially damaging impacts to the economy and a price floor

that protects the integrity of allowances. FPLE recognizes concerns that a safety valve may allow emitters to continue to emit GHGs without achieving significant reductions, however we assert this will occur only if the safety valve price is set too low. The safety valve price must be set high enough to promote changes in behavior but not at a level that will risk adverse economic repercussions. Furthermore, FPLE believes that the market prices for CO2 emissions allowances should include a floor price. This ensures the price signal for carbon will be sufficiently high enough to change behavior, promote new technology development, and facilitate energy conservation. A price floor also protects the value of allowances and guarantees there will be some at least some minimal cost placed on carbon. We believe there is inherent risk for greater allowance cost volatility in the cap and trade methodology without these safeguards. Utilizing a ceiling and floor allowance cost bracket minimizes the risk of this volatility, providing greater cost certainty to regulated entities and consumers.

Section 4 Comments--FPLE Supports an Upstream Approach to Carbon Regulation

FPLE found the discussion of Programs 1-4 on the methods for regulating GHG emissions very informative. We understand the Committee's "sense that the preferred approach is"[2] to initially regulate the first sellers of electricity and large industrial emitters, and later include transportation and building sectors in subsequent phases of the program (Program 2). FPLE suggests that incorporation of the transportation and building sector should not be delayed. The regulation of GHG emissions should be economy wide and upstream including all sectors initially as was described in Program 4. Upstream regulation is a more efficient method of regulating a vast majority of all the GHG emissions and sending a clear price signal for carbon throughout the entire economy. We believe that there should be ample time through the regulatory development process to identify protocols for monitoring and verifying upstream emissions from all sectors in order to make an upstream regulatory program work. FPLE also believes that there are significantly greater benefits to regulating the carbon emissions from only 50 facilities under Program 4 as opposed to the regulation of 480 facilities under the Program 2. Program 4 provides an opportunity to develop a relatively simple tool for corrective action if the program is not performing according to expectations. A simple adjustment to the upstream cost of carbon can drive the price signal in the economy. The price of carbon can be adjusted higher if the targeted reductions are not being met or adjusted lower if the price signal is causing unnecessary economic impacts to consumers and the economy.

Section 5 Comments—FPLE cautions against muting the costs of carbon reduction to consumers.

FPLE strongly supports the Draft Report recommendations to use allowance generated revenues to invest in efficiency improvements, technology research and development, and impact mitigation. It is apparent that future significant reductions of

[2] Draft Report, Section 4, p. 37.

GHG emissions will be dependent on advances in technology. We suggest that a significant portion of the allowance value be allocated to energy efficiency as well as research and development activities. Short-term reductions of GHG emissions will be highly dependent on behavioral changes by consumers and the use of more energy efficient appliances, lighting, air conditioning, and residential construction materials. We agree with the MAC finding that public acceptance and participation in the reduction of GHG emissions is vital to the success of the program. Therefore, we caution the Committee not to mute the impacts of the carbon price signal by recommending the rebate of significant allowance value to all consumers. We would suggest limiting such rebates to low income or disadvantage consumers and adversely impacted small businesses.

Section 6 Comments –FPLE Supports Auctioned Allowances.

The MAC has recommended a near term allowance allocation method that includes a share of free allowances to certain sectors combined with an auction of the rest of the allowances. Historical emissions allowance programs have shown that free allocations of allowances create winners and losers depending on the allocation methods utilized. Free allocations also mask the true societal cost of GHG emissions, particularly to the consumer. FPLE is in the camp of those Committee members that have recommended a 100% allowance auction. A 100% allowance auction is simpler to administer than a free allowance allocation method. We also view the purchase of auctioned allowances as a true "user fee" that sends a clear price signal for carbon throughout the economy. FPLE does suggest that the MAC include in their recommendations that none of the revenues generated from allowance auctions be absorbed into the state's General Fund. The auction allowance proceeds should be entirely recycled back into the economy to offset the impacts of carbon regulation by promoting new jobs, promoting new technologies that reduce carbon emissions, and providing rebates to low income families.

If the MAC chooses to support free allocations of any portion of the allowances, FPLE recommends clarification of the method to be utilized. For the electric generation sector, we suggest that an output based allowance allocation method is the most effective and fair form of allowance allocation. An output based allocation method rewards energy efficient projects in contrast to input based allocation methods utilized in the NOx SIP Call or Acid Rain Programs. Input based allocations based on historical fuel use reward less efficient generating facilities with more allowances because a higher percentage of allowances go to the least efficient units. An output based allowance allocation methodology distributes allowances based on emissions per the output of a product (i.e. lbs/MWh) and thus promotes efficiency.

Section 6 Comments –FPLE Supports Use of Offsets.

The utilization of offsets in a cap and trade program has strong supporters on both sides of this issue. FPLE is in agreement with the MAC recommendation for the use of offsets.[3] In the context of electric generation, the need for offsets is paramount because there are not any economically feasible CO_2 removal technologies available. The absence of these technologies limits compliance options to efficiency improvements, fuel switching, and the use of offsets. We conclude that offsets are an essential element, at least in the near term, in any viable GHG cap and trade program. In addition, we stress the same concerns the MAC has expressed concerning the verifiable criteria offsets must meet in order to be considered acceptable.[4] If there is any doubt that offsets are real reductions in GHG emissions, the value of allowances and the credibility of the whole program will be adversely impacted.

FPLE appreciates the Market Advisory Committee member's efforts to develop the Draft Recommendations Report and hope these comments are helpful in your further evaluation of California's greenhouse gas reduction policies. If you have any questions please contact me by phone at 415-703-6000 or by email at diane_fellman@fpl.com .

Very truly yours,

Diane Fellman
Director, Regulatory Affairs

[3] Draft Report, Section 6.3, p. 61
[4] Draft Report, Section 6.3, p. 59